



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

MONDAY, SEPTEMBER 22, 2008

**CITY HALL, KIVA CONFERENCE ROOM
3939 NORTH DRINKWATER BLVD
SCOTTSDALE, AZ 85251**

PRESENT: W.J. "Jim" Lane, Chair
Wayne Ecton, Councilman
Ron McCullagh, Councilman (Arrived at 3:08 p.m.
Departed 5:03 p.m.)

STAFF: Brent Stockwell, City Auditor's Office
Lisa Gurtler, City Auditor's Office
Joyce Gilbride, City Auditor's Office
Susan English, City Auditor's Office
Neal Shearer, Assistant City Manager
Roger Klingler, Assistant City Manager
Craig Clifford, Financial Services
Richard Chess, Financial Services
Brian Dygert, WestWorld

Call to Order/Roll Call

Chairman Lane called the Audit Committee meeting to order at 3:06 p.m.

Roll call was taken confirming the presence of Chairman Lane and Committee Member Ecton.

1. Approval of Minutes from the Regular Meeting on August 25, 2008

Committee Member Ecton made a motion to approve the August 25, 2008, minutes. Chairman Lane seconded the motion. The minutes were approved by a unanimous vote of two (2) to zero (0).

2. Discussion of Audit Reports No. 0526B-G, WestWorld Financial Operations

Assistant City Auditor Joyce Gilbride presented the Committee with Audit Report No. 0526B-G, in which six agreements/licenses were reviewed. Chairman Lane asked Ms. Gilbride to review each section with the Committee.

Ms. Gilbride said the Facility Use Licenses section involved a review of facility use licenses for equestrian and non-equestrian events, as well as the three signature events held at WestWorld. The audit revealed that in many cases fees were not consistent with the rate schedule approved by the City Council.

Chairman Lane noted that questions about pricing are often answered by the statement that staff enters into temporary facility use license agreements for events at WestWorld consistent with the authority granted to staff under Scottsdale Revised Code 2-221(c), and that staff is working with the City Attorney's Office to clarify that section of the City Code to specify authority delegated to the WestWorld General Manager. He asked for clarification regarding this issue. Assistant City Manager Roger Klingler explained there are probably hundreds of facility use licenses issued during a year. They are one-year licenses that have been worked out with the City Attorney's Office. If the licenses are longer than one year, they require City Council approval. The Council approved a code provision allowing the City Manager or designee to enter into contracts that are less than one year, which is what staff have historically relied upon in negotiating agreements. The nature of the idea is to allow the on-site General Manager the flexibility to make adjustments during fluid events.

Chairman Lane asked if there is a list of rates used to negotiate contracts. WestWorld General Manager Brian Dygert agreed there is a rate schedule for WestWorld; however, there are requests for different packages depending upon the event itself. Chairman Lane asked if the City had any legal obligation to maintain consistency on the rates. Financial Services General Manager Craig Clifford explained the Bureau of Reclamation (BOR) has signed off on the fixed rates. Their main concern when setting rates is they not be greater than what would be seen at a comparable facility. Ms. Gilbride clarified that the BOR has had a concern regarding the consistency of rates in the past, and want to ensure that all parties are treated equally.

Committee Member Ecton discussed the WestWorld Subcommittee's role in rate setting, and said during his time on the Committee he was never briefed on what his responsibilities and authority were. In many cases the subcommittee was presented with agreements that did not follow the regular rates, and suggested the WestWorld Subcommittee's authority and responsibilities be clarified in the future. Mr. Klingler suggested passing that information on to the appointing body of the subcommittee.

Chairman Lane asked if the basis for deviations from standard rates is documented in any way, expressing concern that the internal controls are not being enforced. Mr. Klingler explained that to be cautious about these situations, any extreme deviations are taken to the Council for a decision. However, staff would like to define the General Manager's authority in that regard. Chairman Lane agreed there should be a defining line as to when the decision should go to a higher authority.

Committee Member Ecton suggested that it at least be justified and documented in the file that it was approved by the General Manager. Chairman Lane agreed, and suggested setting tiers as to what level of reduction requires review past the General Manager. Mr. Dygert said WestWorld staff is now documenting the files much more thoroughly than in the past.

In response to an inquiry by Chairman Lane, Mr. Klingler explained that staff wanted to clarify with the City Attorney the section of the City Code that deals with City-owned facilities, and whether WestWorld falls under that designation.

Chairman Lane suggested guidelines be set for the basis of deviations, and control mechanisms included by way of documentation. Mr. Dygert stated he has been discussing new policy with staff regarding fee waivers and negotiations, and once that is in place any GM would be able to follow it. Chairman Lane asked that internal controls be put in place to define guidelines for fee deviations, and that they be documented properly in the future.

Mr. Stockwell said he felt it was sufficient that WestWorld staff acknowledged the conditions outlined in the audit and agreed to work with the City Attorney's Office to clarify the language. He said the Audit Department would follow up at a later date to ensure the exception has been addressed.

Chairman Lane said since this is a final report, he believes some additional clarity should be included in Item 1 so it is clear in the future. Committee Member Ecton said it is not within the Committee's authority to ask them to change the report. The minutes should include what the exceptions were and how they were addressed, and answer any questions that may arise in the future.

Chairman Lane noted Item 2 references Page 9 where City Council approval was not obtained for two long-term agreements at WestWorld, and said he could not locate where it indicated these two exceptions. Ms. Gilbride clarified it is located on Pages 10 and 11, and involve the Barrett-Jackson Classic Auto Auction and Arabian Horse Show.

Chairman Lane noted that new procedures have been put in place to ensure supporting documentation for changes to events is complete, accurate, and timely. He asked what procedures were in place before these changes. Mr. Dygert explained while there were procedures in place before, they were not efficient due to WestWorld's size.

Chairman Lane asked if the previous procedures led to any exposures. Ms. Gilbride said from the fieldwork she reviewed, exposure was minimal. Some labor hours did not get from a work order onto an invoice. The monetary value of the exposures did not rise to the level of being a significant finding.

Committee Member Ecton noted when the City took over WestWorld, there was an effort to move forward as quickly as possible, and some of the details were not attended to.

Ms. Gilbride discussed WestWorld caterer and food concession agreements, noting there were appropriate checklists and documentation in place; however, auditors did find issues with some of the forms that were being used that did not clearly spell out how a caterer should calculate their use fee due to the City. The majority of the problems noted in the report have already been corrected.

Chairman Lane said Number 8 in the report notes that the use fee percentage for outside caterers was missing from the WestWorld rate and fees schedule effective July 1, 2007. Additionally, the fee for food concessionaires was listed incorrectly on the schedule as 20 percent of net sales. He asked if those fees were charged, or whether the fee schedule was simply ignored. Ms. Gilbride said while the fees should have been 20 percent of gross sales, there was an issue with one vendor in particular who was deducting all of their expenses before calculating their use fee. A sampling showed the shortage to the City was approximately \$8,000 over two years. WestWorld corrected the issue early on in the audit. Chairman Lane asked how large of a sample was represented. Ms. Gilbride said it appeared to be one vendor that was consistently used for catering events. In response to an inquiry from Chairman Lane, Ms. Gilbride clarified that the contracts were generally written correctly, and the fee schedule has been corrected to reflect the requirement of 20 percent of gross sales.

Ms. Gilbride explained an issue with the concession agreements that came up across the board was the fact that the privilege taxes were not being remitted from the revenue that WestWorld was receiving from the vendors. There is a portion that should be paid to Maricopa County, as well as a portion that should be remitted to the City itself. Chairman Lane noted that when the City purchased the WestWorld management rights in 1997, the concession revenue was considered not to have tax implications. Ms. Gilbride clarified it has always been taxable, but staff's interpretation was incorrect in that regard and the revenue is taxable based on the City's code.

Chairman Lane asked if there was a financial impact in this regard. Mr. Clifford said the City's tax returns should have been submitted differently. Ms. Gilbride explained concession fees are typically not considered to be taxable, but under the City code it is a licensing for use of that space and is taxable. Mr. Klingler said a portion is now paid to Maricopa County.

In regard to Number 5, Chairman Lane noted that nine out of ten vendors were missing proof of insurance for at least one form of coverage required as a condition of being an approved concessionaire or caterer. The report answers that concern by indicating there are numerous small businesses on the approved vendor list that do not engage in all the insurance requirements. Chairman Lane asked if there was a tiered system for small businesses as far as insurance coverage is concerned. Mr. Dygert explained that the contracts for small and large concessionaires are the same, and rather than modifying the contracts, documentation is included in the file that is signed off on by the vendor when insurance does not apply. This ensures the contract requirements are still being met.

Chairman Lane noted the report states that the controls for the restaurant are adequate but not being enforced. Ms. Gilbride said although the agreement is well written, there has been a problem with contract administration and enforcing the terms of the agreement. In particular, there was no historical record of the inventory for the restaurant, and without knowing the starting point it was difficult to document what should or should not have been replaced.

In response to an inquiry by Committee Member Ecton, Mr. Dygert clarified the same contract administrator will be handling all of the contracts.

In regard to special event liquor licenses, Ms. Gilbride explained the biggest issue was when the right to serve alcoholic beverages is given up as a concession to an event promoter, and ensuring that the same compensation (30 percent) is being received. All facility use agreements state that the restaurant is the only entity that can serve alcoholic beverages; however, the City does have the right to ask them to give that up if it wants to allow that privilege to an event promoter. Chairman Lane asked if it is understood that when the restaurant lends that license out they need to collect the 30 percent. Ms. Gilbride explained they did not, and there has been a financial consequence to the City.

Committee Member Ecton asked if this has been resolved. Mr. Klingler said since he has been involved in WestWorld there have been no special event liquor licenses issued where the City has not received 30 percent unless the Council waived it.

Mr. Klingler discussed the issues that arise when negotiating contracts on federal government, public recreation purpose facilities like WestWorld.

Committee Member McCullagh asked when Monterra's is open, and Mr. Dygert indicated when WestWorld or the restaurant has booked events. As a catering and banquet facility, they do not have regular business hours.

Committee Member McCullagh asked who drafted the proposed agreement with Barrett-Jackson. Mr. Dygert clarified the City Attorney's Office drafted that agreement. Committee Member McCullagh asked if that was the normal process for any contracting the City does at WestWorld. Mr. Dygert agreed the normal process is for the City to draft those documents.

Ms. Gilbride reviewed the portion of the audit report covering paid parking practices, noting the agreement has a lot of good controls written into it that have not been exercised. It is a cash business, and the agreement has a provision for an unannounced audit at any time or location. Some exceptions found included lack of daily deposit receipts and tracking of parking passes.

Ms. Gilbride discussed the sales tax issue and the fact that the revenues and expenses are being netted. The City does not see the true amount of revenue resulting from a parking operation because they are allowed to deduct their expenses and management fee. Technically, sales tax would be due on the entire receipts from the parking operation, but the vendor is permitted to only remit the balance to the City. Mr. Richard Chess explained that although the City only receives information regarding the net amount, it pays the privilege tax on the gross amount. Mr. Dygert explained the language in the new Request for Proposal (RFP) has been changed to address this issue.

Ms. Gilbride discussed the feed and bedding contract, indicating it was not very well written and missing many controls. The contract was one of the older agreements, and is now no longer in effect. The agreement required no real method of documenting sales on a daily basis, and many times the vendor asked WestWorld staff for assistance in preparing reports which negated the City's ability to audit the function. In response to an inquiry by Chairman Lane, Mr. Klingler stated this is now an in-house function.

Committee Member McCullagh asked why it was advisable to bring this function in-house as opposed to any other vendor service. Mr. Dygert said due to customer service, fuel prices, and profitability, it was determined this function should be contained in-house. In response to an inquiry by Committee Member McCullagh, Mr. Dygert responded the City should net between \$80,000 and \$100,000 for these services. Mr. Clifford clarified that it is a required service, and the City is in the best position to manage those needs. A vendor would be subject to WestWorld's schedule, and due to costs it was prohibitive to even bid on the contract under the City's terms. Mr. Chess said all issues brought up during the audit have been addressed in minute detail by bringing these services in-house; the operation and accounting will be much more efficient.

Committee Member Ecton said the demands of the users at the horse shows can be difficult to manage. For that reason, these services are traditionally handled in-house at similar facilities.

The Committee accepted Audit Report No. 0526B-G, WestWorld Financial Operations, as presented.

3. Discussion of Preserve Gateway Property Acquisition Report

Mr. Stockwell informed the Committee that the report is complete, and staff has tried to be consistent with the Council action from April 15, 2008.

Committee Member Ecton recognized this was a difficult task, and noted the recommendations in the report were reasonable but constrained by lack of knowledge in terms of what had been said in executive sessions.

In regard to Recommendation No. 1, Committee Member Ecton stated he knew for a fact that all the departments were involved in the process, and he was comfortable that all the appropriate people were involved at the time. Committee Member Ecton discussed Recommendation No. 2, and indicated there are simple processes in place in regard to Preserve land acquisition: donation, purchase, or condemnation. The City has logically followed that very consistently, and the Preserve Commission reports to the Council yearly. In regard to Recommendation No. 3, Committee Member said there is a formalized process, and there will be no discussions in the City about whether or not it buys this land. The boundaries have been defined and it is the City's responsibility to pursue it.

Committee Member McCullagh said he does not agree with the recommendations that have been made in this report. Recommendation No. 1 adds a layer of bureaucracy to a process that is already being handled by staff. With respect to Recommendation No. 2, staff should know what their responsibility is in regard to their oversight. Recommendation No. 3 addresses a formalized Preserve land acquisition process, and Committee Member McCullagh stated it is his understanding that is what staff is supposed to be doing. Committee Member McCullagh said that Preservation staff should take a more proactive role in the things that are being recommended in this report.

Chairman Lane asked what staff were involved in the acquisition process. Mr. Stockwell indicated different people were involved at different points in the process. Early in the

process, Preservation Director Bob Cafarella was involved. Kroy Ekblaw was Planning & Development General Manager at the time and Deputy City Attorney Donna Bronski was also involved in the pre-auction period. Craig Clifford, Financial Services General Manager was also involved at times. Post-auction, former City Attorney David Pennartz and other former city attorneys, former Assistant City Manager Ed Gawf, former City Manager Jan Dolan, and Sr. Assistant City Attorney Bruce Washburn were involved. Chairman Lane asked if all of these people were interviewed during this process. Mr. Stockwell stated many of them were, but the primary focus was on the documentation that was available. Chairman Lane expressed concern that former City Manager Jan Dolan was not interviewed in this process, particularly since she was involved in some pre-auction verbal agreements with prospective bidders concerning turning back property to the City. Ms. Gurtler clarified that according to the court testimony and through the interview process for this project, those verbal assurances were made with Mr. Cafarella. The Toll Brothers attorney later denied that he provided a verbal assurance, but that could not be confirmed.

Chairman Lane said while he does not necessarily disagree with the recommendations, the findings that led to them seem to be lacking. He indicated he was concerned about who the parties were which were involved, and what the Council relied upon in making their decisions. He opined that relying upon verbal agreements in the future would not be advisable. Mr. Stockwell explained that was explored while developing the report. There are challenges with relying on verbal assurances; however, there was not enough information on which to make a recommendation relative to that.

Chairman Lane clarified he would expect a summation of findings that lead to the conclusions and recommendations to be included in the executive summary. Mr. Stockwell agreed, and explained this is the first experience the Auditor's Office has had in doing a special project like this. Chairman Lane indicated he appreciates this was not an easy task, and indicated in the future he will be looking for these elements.

Chairman Lane expressed his concern regarding the Council relying upon verbal agreements by Mr. Cafarella, and said he believed those agreements should have been made by the City Manager.

Ms. Gurtler clarified that under each of the recommendations, examples were given of why that recommendation was chosen; however, for purposes of creating this report, staff did not have the advantage of knowing whether the issues were discussed in an executive session.

Ms. Gilbride asked if the Committee found the report to be helpful at all as far as answering any questions about what took place. Committee Member Ecton indicated he did not see a lot of benefit in the report. Councilman Lane said he thought it was a reasonable exercise to try to find out if there were steps that could be taken or not taken that would remedy things going forward. In that sense, there is some communication of that in the report. However, he indicated he did expect to see more details.

Committee Member Ecton said he believes the duties and responsibilities of the Preserve Commission should be better defined. He said one benefit of the report was that there was nothing found that was terribly wrong, but he did not necessarily agree with the recommendations.

The Committee discussed the Preserve boundary and the statement that “the line is the line,” and Chairman Lane clarified how properties within the boundary are purchased and what options the City has in that regard. It is not a matter of if the City is going to buy properties within the boundary or not, it is how to effectively do it. He indicated he was hoping the report would make clear whether the City did something in the process that might be amended or changed that would make it better next time.

The Committee Members thanked staff for their hard work on this project.

4. Staff update and discussion regarding status of current audits and projects

Mr. Stockwell noted two reports have been sent for management response, staff is wrapping up work on one additional audit, and two additional audits have been started. Staff has been working to streamline the report review process, and is on target to complete 15 reports within the fiscal year. He provided the Committee Members with materials regarding these items.

The Audit Department has been down one position for the last two months, and an offer has been extended for a new senior auditor. There are plans to move the Audit Department to the new location by the end of October.

Committee Member Ecton expressed his thanks to staff for keeping on schedule.

5. Discussion of Agenda Items for next Audit Committee meeting to be held at 3:00 p.m. on Monday, Oct. 27, 2008

Mr. Stockwell indicated staff intends to bring the Workers' Compensation and Cash Handling Audits to the Committee next month.

He stated he received a request to include an item for discussion and direction regarding the recruitment of a permanent City Auditor, as well as discussing how to get input from the Audit Committee early in the audit process.

Public Comment - None.

Adjournment

With no further business to discuss, the Audit Committee meeting adjourned at 5:15 p.m.